FILE COPY



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

---

# No. 222

---

ILLINOIS CENTRAL RAILROAD COMPANY,
*Appellant,*

*vs.*

STATE OF MINNESOTA.

---

APPEAL FROM THE SUPREME COURT OF THE STATE OF MINNESOTA.

---

## STATEMENT AS TO JURISDICTION.

---

DOHERTY, RUMBLE, BUTLER, SULLIVAN
& MITCHELL,
R. C. BECKETT,
CHAS. A. HEISELL,
*Counsel for Appellant.*

V. W. FOSTER,
E. C. CRAIG,
*Of Counsel.*

# INDEX.

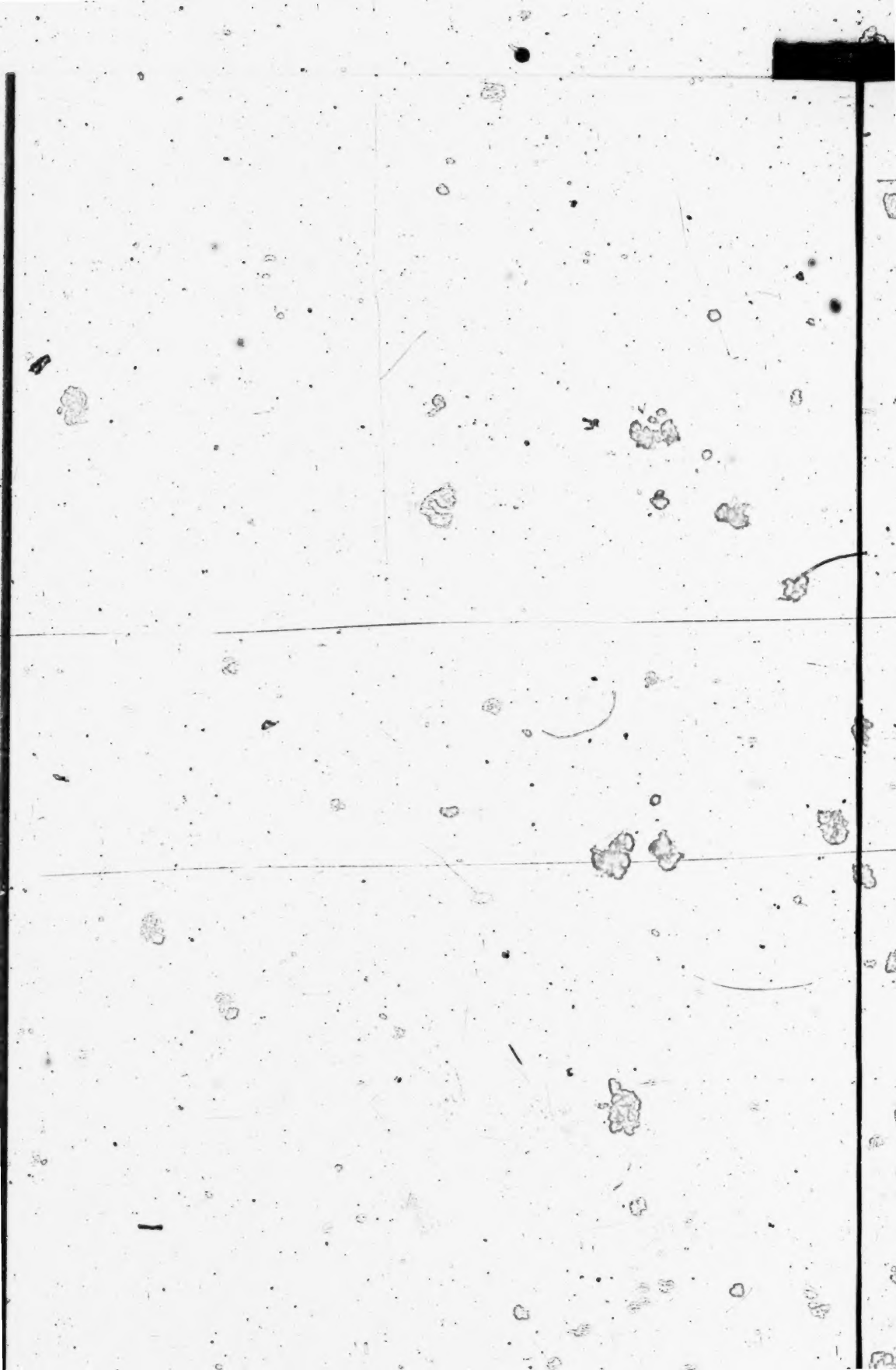
## Subject Index.



## Table of Cases Cited.



## Statutes Cited.



STATE OF MINNESOTA, IN SUPREME COURT

No. 32158.

STATE OF MINNESOTA,

*vs.*

*Respondent,*

ILLINOIS CENTRAL RAILROAD COMPANY,

*Appellant.*

## BASIS UPON WHICH IT IS CONTENDED THE SUPREME COURT OF THE UNITED STATES HAS JURISDICTION.

It is provided by Section 237 Judicial Code, as amended (28 U. S. C., Sec. 344(a)):

> "A final judgment or decree in any suit in the highest court of a State in which a decision in the suit could be had, where is drawn in question the validity of a treaty or statute of the United States, and the decision is against its validity; or where is drawn in question the validity of a statute of any State, on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, and the decision is in favor of its validity, may be reviewed by the Supreme Court upon appeal."

Section 2246 Mason's Revised Statutes of the State of Minnesota, 1927, provides (Vol. 1, p. 544):

> "Gross earnings—Every railroad company owning or operating any line of railroad situated within or

partly within this state, shall, during the year 1913 and annually thereafter, pay into the treasury of the state, in lieu of all taxes, upon all property within this state owned or operated for railway purposes, by such company, including equipment, appurtenances, appendages and franchises thereof, a sum of money equal to five per cent of the gross earnings derived from the operation of such line of railway within this state.

"On or before August 15, 1913, and annually thereafter, each such railroad shall make, according to law, a true and just return of all such gross earnings for the six months ending June 30th next preceding, and the said tax of five per centum thereon shall become due and payable to the State of Minnesota in manner provided by law, on September 1st next thereafter.

"On or before February 15, 1914, and annually thereafter, each such railroad company shall make, according to law, a true and just return of all such gross earnings for the six months ending December 31st next preceding, and said tax of five per centum thereon shall become due and payable to the State of Minnesota in manner provided by law, on March 1st next thereafter; and the payments of such sums at the times hereinbefore set forth shall be in full and in lieu of all other taxes upon the property and franchises so taxed."

Section 2247 Minnesota Revised Statutes provides (Vol. 1, p. 545):

"'Gross earnings' defined—The term 'the gross earnings derived from the operation of such line of railway within this state,' as used in section 1 of this act is hereby declared and shall be construed to mean, all earnings on business beginning and ending within the state, and a proportion, based upon the proportion of the mileage within the state to the entire mileage over over which such business is done, of earnings on all interstate business passing through, into or out of the state."

On June 16, 1939, by opinion filed in the office of the Clerk of the Supreme Court of the State of Minnesota on that date the Supreme Court affirmed the judgment of the District Court of Ramsey County, Minnesota against defendant in the sum of $28,157.95, being the alleged amount of omitted gross earnings taxes for the years 1922 to 1929, inclusive. Judgment based on this decision was entered against appellant on the 30th day of June, 1939, in the sum of $28,157.95. Application for an order allowing this appeal was made to the Chief Justice of the Supreme Court of Minnesota on the 30th day of June, 1939.

The affirmance of the judgment by the Supreme Court of Minnesota on June 16, 1939, and the entry of judgment thereon on the 30th day of June, 1939, was the first final judgment in this cause, although the case had been before the Supreme Court of Minnesota on two previous occasions, the decisions being reported in *State* v. *Illinois Central Railroad Co.*, 274 N. W. 829, 200 Minn. 583; rehearing denied, 275 N. W. 854; on the second appeal reported in 284 N. W. 360, and on the third appeal reported in — N. W. —. The three decisions of the court on these appeals and the decision on petition for rehearing are attached hereto and by reference made a part hereof.

## Nature of the Case.

The action was brought in March, 1934 by the State of Minnesota in the District Court of Ramsey County to recover the amount of alleged omitted gross earnings from freight car per diem receipts for the years 1922 to 1929, inclusive. The amount sought to be recovered was $89,724.36 with statutory penalties and interest. This amount was computed in accord with a formula which appeared from the figures set forth in the complaint, but which formula was subsequently abandoned at the trial when found to be impracticable. After the conclusion of the first trial

in the District Court and for the first time claim was made by the State in a motion for new trial to recover under the so-called Burlington formula, a formula never pleaded, never adopted as required by the statute, by the State examiner (later comptroller) with the approval of the Tax Commission, and only used by the State in the compromise settlement of several other lawsuits against other carriers. Appellant had paid its taxes during the years in question (1922-1929) in exact accord with the system of accounting prescribed by the State.

The Minnesota statute (Sec. 2239, Mason's Revised Stats. 1927, p. 544) specifically authorizing the public examiner, not the court, to prescribe the system of accounts or formula, reads as follows:

> "Uniform system of accounting—The public examiner, with the approval of the tax commission, shall have authority and power to prescribe for such companies, joint stock associations, co-partnerships, corporations, or individuals a system of gross earnings accounts, that shall be uniform for each class of companies, and he shall supervise the method of keeping such accounts; provided, that such system shall conform as nearly as practicable with that prescribed for such companies by the United States government."

The State of Minnesota appealed from the first judgment in its favor amounting to $12,866.50, which amount was arrived at under a formula advanced by the trial court. This formula was rejected and the judgment reversed on the State's appeal. (*State* v. *Illinois Central Railroad Co.*, 200 Minn. 583, 274 N. W. 829.)

On the second trial the District Court adopted the Burlington formula and denied the motions of both parties for amended findings and for a new trial. This was affirmed (*State* v. *Illinois Central Railroad Co.*, 284 N. W. 360). The case was remanded to the District Court for the entry of

judgment, from which the third appeal was taken, the judgment was affirmed June 16, 1939, and judgment entered in the Supreme Court of Minnesota on the 30th day of June, 1939.

It is contended that the Supreme Court of the United States has jurisdiction of this appeal under the specific provisions of Section 237 of the Judicial Code, as amended (28 U. S. C., Sec. 344(a)). Since the Supreme Court of Minnesota has upheld the validity of the statute notwithstanding appellant's contention that the State's construction of such statute violates the Federal Constitution, defendant is entitled to this appeal. *West Coast Hotel Co.* v. *Parrish*, 300 U. S. 379, 57 S. Ct. 578, 81 L. Ed. 703.

A "statute of any state," decision concerning the constitutionality of which may be reviewed on appeal, is not limited to enactments of the State legislature, but includes every act, legislative in character, to which the State gives the force of law, such as an order of a State tax commission, or the decision of a court substituting its choice of a formula for that prescribed by the commission.

*King Mfg. Co.* v. *City Council of Augusta* (1928), 277 U. S. 100, 48 S. Ct. 489, 72 L. Ed. 801;

*Live Oak Water Users' Ass'n* v. *Railroad Commission of State of California* (1926), 269 U. S. 354, 46 S. Ct. 149, 70 L. Ed. 305;

*Hamilton* v. *Regents of University of California* (1934), 293 U. S. 245, 55 S. Ct. 197, 79 L. Ed. 343;

*Lake Erie & Western R. R. Co.* v. *State Public Commission ex rel. Cameron*, 249 U. S. 422-4;

*Sultan Ry. Co.* v. *Dept. of Labor*, 277 U. S. 135.

**Constitutional Questions Raised.**

The questions involved are substantial. Notwithstanding the objections made on constitutional grounds, the State of Minnesota seeks to collect by suit brought in 1934, under

a formula suggested to the court in a motion for new trial filed in 1935, some $89,000 in taxes on freight car *per diem* earnings alleged to have been earned in 1922 to 1929, inclusive. The additional taxes are sought to be collected notwithstanding the admitted fact that the railroad company paid every cent of taxes due under the formula prescribed by the State Comptroller and Tax Commission acting under specific statutory authority for the years in question. There is involved the right of the Minnesota court to adopt a formula, under which part of appellant's alleged gross earnings are allocated to Minnesota for taxation, notwithstanding the existence of a specific statute vesting such authority in the Comptroller and Tax Commission of the State.

There is further involved the right of the State to apply such formula retroactively to years antedating the application by as much as thirteen years. There is further involved the right of the State to adopt a formula which, as shown without dispute in the record, results in the payment of no tax whatever by most of the roads in the State and by many which do many times more business in the State than appellant.

The constitutional objections now relied upon were raised in the answer filed in the District Court of Ramsey County, Minnesota, on which the case was first tried; were renewed at the time of the first appeal taken by the State and were again renewed on the second and third appeals.

These objections, more specifically shown in the assignment of errors, are: That the gross earnings statute of the State of Minnesota, construed so as to permit the application of the Burlington formula, deprives defendant of its property without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States; that the statute construed so as to permit the application of the Burlington formula and retroactively applied in 1939 (or 1935 when it was first suggested in the State's motion for a new trial) to the years in question, 1922 to 1929, in-

clusive, becomes so arbitrary, unreasonable and capricious as to take defendant's property without due process of law; that the statute construed to permit the application of the Burlington formula is so inaccurate an approximation in lieu of the real facts that the imposition of a tax based thereon is the taking of property without due process; that such construction of the statute, which by its terms imposes a property tax, permits double and unequal taxation in violation of the commerce clause and equal protection clause of the Federal Constitution; that such a construction results in an unreasonable burden on interstate commerce in that it is a tax on cars in transit which do not have a taxable *situs* in Minnesota; and finally, that the application of the so-called Burlington formula whether dependent upon a construction of the gross earnings statute or not, is so grossly inaccurate, arbitrary, capricious and unreasonable as to violate the due process clause, the equal protection clause and constitutes an unreasonable burden on interstate commerce.

WHEREFORE, Appellant respectfully submits that the Supreme Court of the United States has jurisdiction upon appeal to review the judgment in this action.

DOHERTY, RUMBLE, BUTLER, SULLIVAN & MITCHELL,
*First Nat'l Bank Building,*
*St. Paul, Minnesota.*

R. C. BECKETT,
CHAS. A. HELSELL,
*135 East 11th Place,*
*Chicago, Illinois.*

V. W. FOSTER,
E. C. CRAIG,
*135 East 11th Place,*
*Chicago, Illinois,*
*Of Counsel.*

## EXHIBIT "A".

STATE v. ILLINOIS CENT. R. CO.

No. 31216.

Supreme Court of Minnesota.

Sept. 10, 1937 (274 N. W. 828).

Appeal from District Court, Ramsey County; James C. Michael, Judge.

Action by the State against the Illinois Central Railroad Company. From the judgment, the State appeals.

Affirmed in part, and reversed in part, with directions for a new trial.

William S. Ervin, Atty. Gen., and Harry W. Oehler, Asst. Atty. Gen., for the State.

Doherty, Rumble, Butler, Sullivan & Mitchell, of St. Paul, and R. C. Beckett and Chas. A. Helsell, both of Chicago, Ill. (V. W. Foster and E. C. Craig, both of Chicago, Ill., of counsel), for respondent.

---

STONE, Justice.

The state sues defendant for a 5 per cent gross earnings tax on income from freight car per diem rentals for a period of eight years, 1922 to 1929, inclusive. The amount claimed was $89,724.36. The state got judgment for $12,866.50, from which it appeals.

Mason's Minn. St. 1927, Sec. 2246, provides: "Every railroad company owning or operating any line of railroad situated within or partly within this state, shall, * * * pay * * * in lieu of all taxes, upon all property within this state owned or operated for railway purposes, by such company, including equipment, appurtenances, appendages and franchises thereof, a sum of money equal to five per cent of the gross earnings derived from the operation of such line of railway within this state."

Under Section 2247, "gross earnings" mean "all earnings on business beginning and ending within the state, and

a proportion, based upon the proportion of the mileage within the state to the entire mileage over which such business is done, of earnings on all interstate business passing through, into or out of the state."

Under the rule of State *v.* Minnesota & International Ry. Co., 106 Minn. 176, 118 N. W. 679, 1007, 16 Ann. Cas. 426, only the amount received by a railroad company operating in Minnesota, for use of its cars, in excess of what it pays for the use of cars of other companies, is included in taxable gross earnings. In practice, accounts are kept between the railroad companies and system balances struck and settled monthly. Because Minnesota can tax no property beyond its own borders and because our gross earnings tax is a levy in lieu of all others on the Minnesota property of railroads operating here (Mason's Minn. St. 1927, Sec. 2246), the incidence of the tax on car rentals is limited by the rule of State *v.* G. N. Ry. Co., 163 Minn. 88, 203 N. W. 453. That rule is this: In order to determine whether a credit balance for car rentals is to constitute gross earnings of the creditor road taxable in Minnesota, "all rentals derived from the use of the cars by companies operating no lines within the state must be excluded, and no more included of rentals from foreign companies extending into the state than the proportion earned from use within the state" of the creditor's cars.

It is of the theory of the case, implicit in the record, the decision below, and all argument here, that, where interstate apportionment of car rentals is needful, it is to be made on the basis of "loaded freight car mileage" (for brevity to be hereinafter indicated merely as mileage). On that basis, therefore, we consider and decide the case.

Defendant is a foreign railroad corporation organized under the laws of Illinois. Since 1904, it has operated, as lessee of the Dubuque & Sioux City Railroad, some 30.15 miles of trackage in Minnesota. Defendant has exchanged freight cars with other roads operating within and without Minnesota. Pursuant to the universal contract among all roads in the United States, the using road is charged one dollar per day per car while in its possession. During the involved eight years, defendant had credits in its favor for

per diem use of its cars by other railroads amounting to $17,427,861.79 and debits in the sum of $14,924,508.63.

The Minnesota Tax Commission had promulgated rules and furnished printed forms for returns. The rules incorporated that of State *v.* Minnesota & International Ry. Co., 106 Minn. 176, 118 N. W. 679, 1007, 16 Ann. Cas. 426, together with the following: "Note—You are to report to the State of Minnesota for taxation purposes, (a) the credit balance, if any, on freight equipment used in transportation service and interchanged with foreign roads on the per diem or mileage basis. Minnesota proportion of said credit balance to be computed by applying the percentage that the average revenue freight car mileage in Minnesota bears to the total average revenue freight car mileage of the entire line during the calendar year."

Made as so required, defendant duly filed returns for every year in controversy. All were accepted by the state, and defendant promptly paid the tax computed thereon. (Those returns used what is now referred to as "defendant's formula." Defendant modestly disclaims its authorship and refers to it as the state's old formula.)

In 1933 the Minnesota Tax Commission adopted a new theory. In the meantime, in the language of Judge Michael: "The defendant's records which would show the number of days its freight cars were in possession of other Minnesota roads, in Minnesota during said eight-year period, were, pursuant to the rules of the Interstate Commerce Commission, destroyed by defendant before this controversy arose, so that the number of car days to be apportioned to Minnesota cannot be determined to a mathematical certainty." That would be impossible in any event because the best of practicable records would seldom if ever disclose just when or where a freight car crossed a state line. The most practicably possible is a record, approximately accurate, of the time freight cars are in use by lines other than the owner.

Upon the state's new formula this suit was based. It ignored the necessity for first getting system balances. Any credit to defendant, although on the system balance more than offset and defendant indebted to the other road, was sought to be taxed. By so much there was attempt to

tax something not an earning. See State *v.* Minnesota & International Ry. Co., 106 Minn. 176, 118 N. W. 679, 1007, 16 Ann. Cas. 426. That doubtless explains why this new formula, has been frankly abandoned by the state.

"Using road" is a self-defining phrase. The "reporting road" is the one making the returns of taxable gross earnings. In the case of the latter's debit balances for car rentals, it is both the using and reporting road. Defendant's mileage in Minnesota is taken as .11 of one per centum of that of its entire system. The application, for present purposes, of that percentage to its own net system credit balances is indefensible for the simple reason that it helps not at all in ascertaining the amount of car rentals earned by defendant's cars in use by other roads in Minnesota. Plainly, for that purpose, the factor of allocation must be the extent of the use of the cars in Minnesota. The reporting or owning road's Minnesota proportion of its whole mileage is in consequence irrelevant; and the Minnesota proportion of the using road's determinative. Because the so-called defendant's formula used the former, erroneous ratio (that of the reporting road), it was properly rejected below.

Judge Michael used a method of his own. Between the defendant and all other lines he first struck one balance for the eight years (by deducting total debits from total credits), to which, for the purpose of determining the Minnesota proportion, he applied the *average* percentage (10.39) that all of the using roads' mileage in Minnesota bears to their total mileage. The Minnesota proportion of defendant's gross credits for the eight years ($17,427,861.79) was $1,811,181.03, or 10.39 per cent of the whole. That rate was taken as indicating the extent of the Minnesota use of defendant's cars by other lines for all the years. *The figures for each system and year were not made or taken separately.*

That method worked out as follows:

| | |
|---|---|
| Defendant's total credits for the 8 years | $17,427,861 |
| Defendant's total debits for the 8 years | 14,924,508 |
| | $2,503,353 |

Taking the credit balance of $2,503,353 as defendant's system earnings from car rentals, and 10.39 per cent thereof as allocable to Minnesota, gives the sum of $260,088. One more subtraction was made, .11 per cent thereof, or $2,753, making the net sum subjected to tax by the decision below $257,350.

The last allowance was fixed by the fact that only .11 per cent of defendant's mileage is in Minnesota. It was erroneous, we hold, because defendant had already been given credit for all debit balances, i.e., for the sums it had paid other lines for the use of cars in and out of Minnesota. The additional and final .11 per cent allowance of $2,753 was, pro tanto, a duplication of one already made.

In the formula adopted below, there is another more serious and pervasive error. Its use of the average percentage for the 21 roads, other than defendant, is erroneous for formulary purposes in this. Only the user's Minnesota proportion of its own mileage is applicable to rentals it pays in order to allocate a proper portion of the latter to Minnesota. But the use of one average Minnesota proportion for all 21 lines makes the multiplier the user's Minnesota mileage in combination with that of all the other lines. Pro tanto, the small Minnesota ratios of the mileage of some lines is applied to the large credit balances due from other lines with a much larger Minnesota mileage. To illustrate: In 1922, the Chicago, Great Western Railway, with a Minnesota mileage of 13.06 per cent of its total, owed defendant a credit balance of $88.26. For the same year, the Minneapolis, Northfield & Southern Railway, with 100 per cent of its mileage in Minnesota, owed defendant a similar balance of $1,666.10. All of the latter was earned in Minnesota. But if the Minnesota average rate of local mileage of the two roads (13.06 plus 100), 56.53 per cent, is applied, the credit to this state is cut almost in half. There is a corresponding increase of the portion of the small Chicago, Great Western balance allocable to Minnesota. The illustration shows the fallacy which condemns any method based upon an average rate per centum of Minnesota use by all the other roads.

Moreover, annualy some roads are creditors of defendant. It owes them for car rentals to which balances is to

be applied only the user's (its own) Minnesota mileage ratio. But if one average for all lines is taken, an assumed Minnesota use by defendant's creditors is included although they have no such use at all for the year in question. The general average per centum, as used by the court, is a constant factor. Its use ignores the factual lack of relation between it, as the multiplier, and the total figures of all the lines used as the multiplicand. There simply is no basis for allowing the Canadian National Railway's mileage ratio of .01 per cent any potency in reducing the much larger Minnesota ratios of all the other roads. Yet that is what happens if the ratios are independently averaged and the result applied as multiplier to the total credits (of all lines) due defendant. In allocating to Minnesota its proper proportion thereof, the figures for each road must be computed separately—its own balance used as multiplicand, and its own Minnesota proportion, in rate per centum, as the multiplier.

Using on their total car rental debt to defendant an average Minnesota mileage ratio for all the roads applies a constant arithmetic mean to 21 variants, some of which are extremely so. The arithmetic mean, or average, becomes unrepresentative in proportion to the amount of aberration in its component items. In consequence, when applied as multiplier to any such item, it produces a product out of line with truth in proportion, not only to the variance from the norm of such item, but also deranged by the influence of the similar variance of the other extreme items used in striking the mean.

What we must somehow determine, as nearly as may be, is the amount of money derived from the use of cars in Minnesota. On that question, what has been paid for such use in other states has no bearing. Hence, in any such computation or formula, defendant should not have credit for the whole of its debit balances. It is entitled only to allowances for the portion of such balances properly chargeable to Minnesota. Defendant is taxable only on rentals for the use in Minnesota of its cars. Therefore, of receipts for allocation to Minnesota, no reductions can properly be made of sums it has paid other lines for the use of their cars outside Minnesota. But the decision below

does just that. Having gotten the Minnesota proportion of all defendant's credit balances, the ruling was that there should then be applied in reduction thereof, in order to get at the sum taxable, the whole of defendant's debit balances, rather than only the proportion thereof chargeable for use of cars in Minnesota. The latter can be computed by using on any such balance, as a multiplier, the Minnesota percentage (.11 per cent.) of defendant's mileage. As to its debit balances, defendant was the using line. Hence, the proportion of such use in, and the proportion of the resulting debt chargeable to, Minnesota is equivalent, for the purposes of a formula, to the Minnesota proportion of defendant's mileage.

In this battle of formulae, those already referred to have been eliminated for reasons stated. There is but one other which counsel style the "Burlington Formula." It was not even suggested below until the motion for amended findings or a new trial. The trial judge rightly considered it "a clear attempt on the part of the state to shift its position, from what it assumed in levying the taxes, in its complaint, and maintained throughout the trial." His view was further that the Burlington formula was no part of the record, "and even if it were, there are not sufficient facts and data in evidence to correctly apply it." This last formula, and best of the lot, was not submitted as such during the trial, but, with the exception soon to be noted, the record does disclose, as will later appear, the "facts and data" to which it may be applied, and that with justice.

We are not trying the case anew. But we are reviewing the record and decision below, and, in the latter, to the extent indicated, we find error that prevents an affirmance. Unless we direct judgment, we must order a new trial, or at least enough of one to furnish adequate basis for the application of what, so far as now appears, is the formula which most fully and with the greatest justice meets the need of the case.

Briefly, the Burlington formula proceeds thus: For each of the eight years, defendant's balances, both debit and credit, with each of the other roads, were struck. The Minnesota proportion of each such credit balance was then reckoned by using thereon as a multiplier the Minnesota

per centum of the using line's mileage. The actual figure for each road for each year was so used. The Minnesota proportion of defendant's credit balances so ascertained for each road for each year, the next step was to allocate to Minnesota its portion of defendant's debit balances, which, on the basis of mileage, is .11 per cent of the total. The Minnesota proportions of defendant's debit and credit balances being so computed, the next and simple step was to subtract total debits from total credits and so arrive at the sum taxable in Minnesota for each year.

It is repetition, but probably justifiable in interest of clarity, to say that as to defendant's debit balances it was the using as well as the reporting line. Because Minnesota should not be charged for what defendant paid for the use of cars in other states, but rather and only with what it paid for their use in this state, the ratio of its Minnesota mileage is applied with obvious propriety to its debit balances to ascertain the portion thereof charged for their use in Minnesota and so to be deducted from the credit balanees in order to get finally the sum locally taxable.

On the merits of the case arithmetically, nothing more need be said. Belated as was its presentation to the trial court, the Burlington formula comes nearer to reaching with justice and accuracy the desired result than any of the others. It should be adopted and prevail unless the ingenuity of counsel and accountants achieves something better. We would order judgment thereon but for the fact that the defendant should have the opportunity by evidence and argument in the trial court to present its own figures and contentions concerning the application to it of the Burlington formula. All the data for its use are in the record now by way of evidence, except possibly those showing the Minnesota percentage of the using line's mileage. Those figures, except for defendant itself, were not presented by evidence. We apprehend that little or no additional evidence will be needed. Counsel should be able to get with certainty, and agree upon, the one set of figures needed and not appearing in the evidence as it stands. To the extent indicated, and to that extent only, there must be a new trial. The figures furnished by the state in aid of its motion for amended findings or a new trial and in argument here indicate that the total

tax for the eight years, computed on the Burlington formula, will be $26,414.59. The only objective of the new trial, if one is necessary for that purpose, is to determine the correct amount.

There is argument for defendant that, because long ago it paid the taxes for the years in question as then computed by proper officers of the state (including an additional amount omitted from the first payment and later demanded), the state is now estopped to claim any additional sum. There can be no such estoppel for the simple reason that in the imposition of taxes the state acts in its sovereign rather than its proprietary capacity. Chicago, St. P., M. & O. Ry. Co. *v.* Douglas County, 134 Wis. 197, 114 N. W. 511, 14 L. R. A. (N. S.) 1074; see State *v.* Horr, 165 Minn. 1, 205 N. W. 444. Had the transaction been in the latter category; that is, had the issues arisen from an ordinary business transaction as distinguished from the functioning of the state as a sovereign, it would be, we assume, a fair target for estoppel under the rule of State *v.* Horr, 165 Minn. 1, 205 N. W. 444, and State *v.* Gardiner, 181 Minn. 513, 233 N. W. 16.

There is also argument that because defendant paid the small additional sum omitted from the first payment as above indicated, pursuant to an audit made by representatives of the state, the latter is bound as by an account stated. See State *v.* Illinois Cent. R. Co., 246 Ill. 188, 92 N. E. 814. Concerning that it is enough to suggest that an account stated as a defense must be specially pleaded. Board of County Com'rs. of Mower County *v.* Smith, 22 Minn. 97. No such defense was pleaded in this case. So we are not required even to consider whether for a tax liability, fixed and imposed by statute, there can be substituted the different obligation of an account stated between officers of the state and a taxpayer.

So far as the decision and judgment below affirm the liability of defendant for the gross earnings tax because of its operation of the involved trackage in Minnesota, they are affirmed. But, for reasons already stated, the judgment in its determination of the amount of the tax is erroneous

and to that extent must be reversed with directions for a new trial of that one issue.

So ordered.

PETERSON, J., took no part in the consideration or decision of the above case.

## EXHIBIT "B".

STATE v. ILLINOIS CENT. R. Co.

No. 31216.

Supreme Court of Minnesota.

Oct. 22, 1937 (275 N. W. 854).

Appeal from District Court, Ramsey County; James Michael, Judge.

On petition for rehearing.

Petition denied.

For former opinion, see 274 N. W. 828.

William S. Ervin, Atty. Gen., and Harry W. Oehler, Asst. Atty. Gen. for the State.

Doherty, Rumble, Butler, Sullivan & Mitchell, of St. Paul, and R. C. Beckett and Chas. A. Helsell, both of Chicago, Ill. (V. W. Foster and E. C. Craig, both of Chicago, Ill., of counsel), for respondent.

---

STONE, Justice.

Defendant's petition for rehearing is denied. But because there must be a new trial to the extent indicated in our decision, which is adhered to, it is proper that we should express ourselves on the following points raised by defendant's petition:

Again we are urged to consider the argument that defendant discharged its full liability to the State by paying the taxes as computed by the Tax Commission and its examiners, long before this suit was brought. Without debate as to its soundness, we allow for the purposes of argument defendant's contention that its answer should be construed as having pleaded the defense of account stated.

With that assumption, the next thing for consideration is the authority of the Minnesota Tax Commission in the determination and collection of gross earnings taxes. Under Section 2239, Mason's Minn. St. 1927, "the public examiner, with the approval of the tax commission" has the "power to prescribe * * * a system of gross earnings accounts * * * provided, that such system shall conform as nearly as practicable with that prescribed for such companies by the United States government."

As matter merely of statutory construction, the proviso conforming the state to the federal system of accounting indicates no intention other than one for regulation of the accounts of those subject to gross earnings taxes. That exclusionary effect but confirms the conclusion, that necessarily would follow in any event, that no power is vested in the public examiner or Tax Commission in any manner to relieve the taxpayer from the fixed obligation to pay the tax imposed by statute.

Absent official power to alter the statutory obligation of the taxpayer, nothing done by the Tax Commission, its examiners or auditors, can create the new obligation of an account stated to qualify that of the taxpayer, or diminish the sum due from it under the law. It is elementary that an account stated creates a new cause of action, independent of the claim or claims which were its original subject matter. Hanley *v.* Noyes, 35 Minn. 174, 28 N. W. 189; Morse *v.* Minton, 101 Iowa 603, 70 N. W. 691; 1 R. C. L. 212.

We have given further consideration to State *v.* Illinois Central R. Co., 246 Ill. 188, 92 N. E. 814, 833. That case went for the taxpayer upon the ground that, in the exercise of the "full power" conferred upon the Governor, there had been a settlement in the nature of an account stated between him and the taxpayer. The controlling thought was that the issue had already been decided by the chief executive of the State, rather than any inferior officer, in the exercise of the "full power" vested in him by the controlling statute. The presumption was invoked that " 'where a duty is devolved upon the chief executive of the state, rather than upon an inferior officer, that it is so because his superior judgment, discretion, and sense of responsibility were confided in for

a more accurate, faithful, and discreet performance than could be relied upon if the duty were devolved upon an officer chosen for inferior duties.' "

The present issue is in no such matrix of law and fact. There has been no final determination by the executive department in the exercise of "full power" vested in the Governor of Illinois and controlling in the case just cited. Here no "full power" has been vested in anybody. The only authority is the one noted, to prescribe a system of accounts. Certainly, nothing more need be said to show how plainly the whole question is left for final settlement by the orderly method of adjudication where resort must be had thereto.

What we have said disposes also of the argument that "the tax commission, not this court, has power to prescribe the formula." The Tax Commission has no power, as matter of accounting or otherwise, to collect taxes under a formula which results in the collection of either less or more than under the law and on the facts is found due from the taxpayer. And we pretend to no ultimate formula-making power. We have only the judicial task of applying the law to the facts, and that we have already done in this case to the best of our present ability.

There is argument which need not be summarized that "the tax as sought to be imposed violates" defendant's constitutional rights. In view of the new trial that has been ordered, defendant will have full opportunity to present that argument below, and make such record as may be necessary to insure its proper consideration. Nothing said in our decision will be construed as foreclosing any defense on constitutional grounds. But the main point remains that the amount due will be determined on the so-called Burlington formula unless a better one appears.

Rehearing denied.

PETERSON, J., having been Attorney General and counsel below, took no part in this case.

## EXHIBIT "C".

STATE v. ILLINOIS CENT. R. CO.

(two cases)

Nos. 31791, 31910

Supreme Court of Minnesota

Feb. 17, 1939. (284 N. W. 360)

Reargument Denied March 14, 1939.

Appeal from District Court, Ramsey County; Gustavus Loevinger, Judge.

Action by the State of Minnesota against the Illinois Central Railroad Company for omitted gross earnings taxes. From orders denying the motions of each party for amended findings, or for a new trial, each party appeals.

Orders affirmed.

Doherty, Rumble, Butler, Sullivan & Mitchell, of St. Paul, R. C. Beckett and Chas. A. Helsell, both of Chicago, Ill. (V. W. Foster and E. C. Craig, both of Chicago, Ill., of counsel), for Railroad Company.

J. A. A. Burnquist, Atty. Gen., Wm. S. Ervin, former Atty. Gen., and Harry W. Oehler, former Asst. Atty. Gen., for the State.

---

HOLT, Justice.

On plaintiff's appeal the judgment in its favor for omitted gross earnings taxes for the years 1922 to 1929 inclusive in the amount of $12,866.50 was reversed. State *v.* Illinois Central Railroad Co., 200 Minn. 583, 274 N. W. 828, 275 N. W. 854. However, all defenses to a recovery for such omitted taxes were therein determined in favor of plaintiff, and also that the judgment should have been for the sum of $26,414.59. The case was remitted with direction that defendant be given the opportunity to prove the existence of a better method for ascertaining the correct credit balances for interchange of freight cars than the Burlington formula, and, in case no better one was proven, that defend-

ant could also urge that the application of that formula contravened some provision of the state or federal constitution. The court below, over plaintiff's objection, permitted an amendment of the answer by adding this paragraph: "That a better formula than the so-called 'Burlington Formula,' and the only one permitted under a proper construction of the statutes, is that which the state adopted and promulgated for the years in question, i.e. that which requires the striking of a system balance and the allocation to Minnesota for taxation of a percentage thereof equal to the percentage of the reporting company's line in Minnesota." Upon the limited issues the court was directed to try, it made these findings: "1. That the application of the Burlington formula does not violate the constitutional rights of the defendant. 2. That the track mileage formula, offered by defendant, is not a better formula than the Burlington formula. 3. That under the Burlington formula there became due and owing the plaintiff from the defendant $26,414.59, (the amount omitted each of the eight years, excluding penalties, is given). 4. That that part of the gross earnings of the defendant, reflected in the net credit balances above set forth, were not included in defendant's semi-annual returns * * * and the same were items of gross earnings not reported. 5. That the Burlington formula was not formally suggested in this particular action until after the first trial, and was then suggested in plaintiff's motion for amended findings or a new trial (November 21, 1935), and the failure to report the freight car per diem earnings for the years 1922 to 1929, inclusive, according to the Burlington formula was not due to the neglect or default of defendant." The conclusion of law was that plaintiff recover $26,414.59, with interest at six per cent from and after the filing of the findings, and costs and disbursements. Each party moved separately for amended findings or a new trial. From the orders denying the motions each party appeals.

Plaintiff's appeal presents only its right to the penalty and interest prescribed in Mason Minn. St. 1927, sec. 2235. The right to penalty and interest under sec. 2240 cannot well arise for the small error or omission discovered by the public examiner was promptly paid. Chapter 487, Laws

1913, as amended by Ch. 308, L. 1927 (secs. 2233 to 2242, Mason's Minn. St. 1927), and Ch. 9, L. 1912, Ex. ess. as amended by Ch. 533, L. 1919 (secs. 2246 to 2250, Mason Minn. St. 1927), cover the law upon which penalties may be claimed. Section 2233 relates to reporting, upon forms prescribed by the tax commission, the gross earnings. Section 2237 provides what shall be done where there is a failure to report or default after notice served. There was no such proceeding during any of these eight years or within a reasonable time thereafter. Plaintiff relies on State *v.* Chicago, Rock Island & Pac. Ry. Co., 181 Minn. 615, 232 N. W. 105, 233 N. W. 866, where penalties were recovered. In that case there was a failure to report certain items of gross earnings, and it was held that the penalty and interest attached when the payment fell due and was not made. Since the enactment of sec. 95 Mason, Minn. St. 1927, the railroad companies could tender payment of part of the gross earnings demanded by the state and thus avoid penalties on such part. As we understand, that is not applicable to the instant case, where proper reports were filed, reports from which the tax was computed that was paid, and from which it could be computed as the court computed it in the first trial, and from which it could be computed under the Burlington formula. There was hence no failure to comply with the bookkeeping and accounts which defendant was required to keep under regulations of the tax commission and supervision of the public examiner. The failure to pay the taxes now found owing was because the statute prescribed no formula for computing the tax from the returns made. It had to be computed according to some formula. It was so computed for the time in question to the knowledge of the state agencies having the enforcement of the gross earnings tax in charge, and no one suspected that a better one could be devised until 1933. Such being the case the taxpayer should not be subjected to penalties for failure to pay the credit balances derived from the interchange of freight cars with the different railroads operating some part of their transportation system within the state. That penalties are not imposed unless clearly called for by a violation of some statutory duty in respect to the return or payment of the tax is illustrated in State *v.* Great Northern Ry.

Co., 160 Minn. 515, 200 N. W. 834. Although in that case interest accrued on the omitted tax after Ch. 398, sec. 3, L. 1917 (sec. 95 of the code) took effect, the plaintiff could not recover such interest. In this action there were not separable items, but one sum of $182,751.30 demanded. Only $26,414.59 was recovered. It would be utterly repugnant to one's sense of justice to penalize defendant when it had paid and the state agencies for each of the eight years in question had accepted certain sums as the credit balances for interchange of cars according to accounts kept and reports made pursuant to statutes. We deem the fifth finding of the court, above quoted, well sustained that the failure to report and pay the credit balances for interchange of cars computed according to the Burlington formula was "not due to the neglect or default of defendant." In the memorandum made part of the findings, the court refers to the fact that there is no statutory liability for interest on a railroad's gross earnings tax, and proceeds thus: "By G. S. 1923, secs. 2235, 2237, and 2240, the gross earnings statutes prescribe what shall constitute a default, what penalties follow a default and what administrative remedial steps shall be taken after a default. Whatever may be the rule elsewhere (see annotation in 96 A. L. R. 925), in this state a taxpayer is not in default if his property is not assessed for taxes without fault on his part, County (of Redwood) *v.* M. P. (Winona) & S. T. Land Co., 40 Minn. 512, 41 N. W. 465, 42 N. W. 473, or where the tax levied is excessive, State *v.* Great Northern Ry. Co., 160 Minn. 515, 200 N. W. 834; State *v.* Hughes Bros. Timber Co., 163 Minn. 4, 203 N. W. 436. There is and can be no claim that the failure to report the freight car per diem earnings for the years 1922 to 1929 inclusive according to the Burlington formula was due to the neglect or default of the defendant. The tax on the freight car earnings demanded by the Minnesota Tax Commission prior to May, 1933, was paid. At all times since May, 1933, the amount demanded has been excessive. The tax computed upon freight car per diem earnings ascertained according to the Burlington formula, unaugmented by unauthorized interest or penalties, has never been certified or otherwise demanded. Hence there never has been a

default and no penalties can be imposed or authorized by the court herein." Plaintiff's appeal must fail.

Defendant assails the Burlington formula as repugnant to state and federal constitutional provisions. If computation of defendant's credit balances from the interchange of freight cars with railroads operating in this state according to the said formula or method reaches accuracy more nearly than any other, all constitutional objections to its use vanish. That such credit balances constitute gross earnings of a railroad has been settled law since 1908. State *v.* Minnesota & International Ry. Co., 106 Minn. 176, 118 N. W. 679, 1007, 16 Ann. Cas. 426; State *v.* Great Northern Ry. Co., 163 Minn. 88, 203 N. W. 453.

The defenses held not valid on the first appeal do not raise any constitutional question, as we see it, but merely fact issues. By reference to defendant's briefs on that appeal, and on the rehearing, it appears that it was exhaustively argued that, since for more than twenty years prior to 1933, the credit balances for interchange of freight cars between railroads had been reported on prescribed forms and computed according to a uniform system or formula upon which the tax was paid, plaintiff should be estopped to now claim any omitted gross earnings tax for the years in question. That defense was definitely rejected. So also was the one that there had been an account stated for any omission to report and pay credit balances for the years 1922 to 1929, inclusive, when the public examiner upon auditing the returns for said years found an omission of $119.13, which he reported to the state auditor, who, pursuant to statute drew a draft therefor on defendant, including $11.91 penalty and $29.54 interest, total of $160.58, which was promptly paid to the state treasurer and his receipt obtained July 20, 1931. The duty and powers of the public examiner by virtue of Sec. 3282, 1 Mason Minn. St. 1927, were emphasized in defendant's said briefs and the contention made that there had been an account stated and paid. It is clear that it was not intended to leave either of these two defenses to be either retried or open to the claim that constitutional provisions required either one to be sustained.

The decisive finding of fact, on defendant's appeal, is the one "that the track mileage formula, offered by the defendant, is not a better formula than the Burlington formula." As we read defendant's evidence it does not even tend to prove that the formula it was permitted to plead and prove would more accurately reflect the credit balances on interchanged freight cars than the Burlington formula. It only showed that some seven or eight of the railroads operating large trackage within the state had no credit balances under the Burlington formula. But, as shown in the former opinion, the trackage operated by a railroad within the state does not measure the credit balances from car rentals of its system that may be allocated to its gross earnings tax here. Defendant's evidence does not refute but sustains the court's findings to the effect that its proposed formula is not better than the Burlington formula.

The order on plaintiff's appeal is affirmed and likewise is the order on defendant's appeal.

PETERSON, J., took no part for reasons given in 200 Minn. 583, 274 N. W. 828, 275 N. W. 854.

**EXHIBIT "D".**

Ramsey County.

No. 32158.

Endorsed: Filed June 16, 1939. Grace Kaercher Davis, Clerk, Minn. Supreme Court.

STATE OF MINNESOTA, *Respondent,*

*vs.*

ILLINOIS CENTRAL RAILROAD CO., *Appellant.*

*Per Curiam.*

Defendant appeals from the judgment entered in the court below after the orders denying the motions of both parties for amended findings or a new trial were affirmed. Decision filed February 17, 1939, rehearing denied March 14, 1939, 284 N. W. 360.

The errors assigned and urged on this appeal were presented on the former appeal and the decision therein must be considered final so far as this court is concerned. It having been found that the Burlington formula for computing the tax on freight car per diem earnings was proper, and that the one proposed by defendant "is not a better formula than the Burlington" it follows that the tax computed according to the Burlington formula violates no provision of the constitution of this state, and we are unable to see that the 14th amendment or any other provision of the federal constitution is violated by the judgment rendered.

The judgment is affirmed.

Mr. Justice HILTON and Mr. Justice PETERSON took no part.